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The Association of Canadian Pension Management
L'Association canadienne des administrateurs de régimes de retraite

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Proposals to Modernize Canadian Tax Rules Applicable to Registered Plans 2.0

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TABLE OF CONTENTS

FOREWORD

ACPM (THE ASSOCIATION OF CANADIAN PENSION MANAGEMENT)

ACPM (The Association of Canadian Pension Management) is a national, non-profit organization acting as the informed voice of plan sponsors, administrators and their service providers in advocating for improvement to the Canadian retirement income system. Our membership represents over 400 companies and retirement income plans that cover millions of plan members.

ACPM believes in the following principles as the basis for its policy development in support of an effective and sustainable Canadian retirement income system:

Diversification through Voluntary / Mandatory and Public / Private Options
Canada's retirement income system should be comprised of an appropriate mix of voluntary Third Pillar and mandatory First and Second Pillar components.

Third Pillar Coverage
Third Pillar retirement income plan coverage should be encouraged and play a meaningful ongoing role in Canada's retirement income system.

Adequacy and Security
The components of Canada's retirement income system should collectively enable Canadians to receive adequate and secure retirement incomes.

Affordability
The components of Canada's retirement income system should be affordable for both employers and employees.

Innovation in Plan Design
Canada's retirement income system should encourage and permit innovation in plan design.

Adaptability
Canada's retirement income system should be able to adapt to changing circumstances without the need for comprehensive legislative change.

Harmonization
Canada's pension legislation should be harmonized.

Introduction

In November 2019, ACPM released its first white paper, *Increasing Support for Retirement Savings: Proposals to Modernize Canadian Tax Rules Applicable to Registered Plans*, setting out our recommended reforms to the *Income Tax Act (*Canada) (the "ITA") and the *Income Tax Regulations* ("Regulations") to better reflect Canada`s current socioeconomic environment and Canadians' increased life expectancy. In this paper, ACPM identifies specific changes to the ITA and the Regulations that build on our previous recommendations in the 2019 paper, many of which were reflected in recent welcomed tax rule changes, including revised provisions for the correction of contribution errors related to defined contribution ("DC") registered pension plans, as well as changes to borrowing by defined benefit ("DB") registered pension plans.

The recommended reforms ACPM highlights in this paper are those ACPM believes are "low hanging fruit`", meaning they could be implemented without major ripple effects in the overall taxation system applicable to registered plans. However, we note that ACPM still stands by its earlier recommendations in the 2019 paper that have not been included in this paper, especially those relating to the "Factor of 9". As we previously noted, in our view, the Factor of 9 should be amended to restore some equity in the tax system between defined benefit (DB) and defined contribution (DC/RRSP) plan members and how much savings may be tax sheltered. DB members can accrue a maximum benefit of 2% of earnings, whereas DC contributions are limited to 18% of earnings (9 x 2% = 18%). The 9:1 ratio between DB and DC plans for contribution purposes and the Factor 9 itself – used in many DB limits, maximum contributions under *ITR 8503(4)* and PA calculations – should at a minimum be changed to reflect current economic and demographic realities. We refer readers to our 2019 paper for a detailed discussion on this important reform tax issue and ACPM`s recommendations on to how to address it.

1. Urgent Reform Needed: Transfer Values – Repeal Regulation 8517 Limits

Pension members who terminate their employment and choose the option of transferring the commuted value of their defined benefit (DB) pension plan to a DC arrangement (such as a Locked-In Retirement Account (LIRA)) are subject to the "Maximum Transfer Value" limits outlined in *Regulation 8517*. In many instances, this means that the member will be forced to take a large portion of the commuted value of their pension benefit in cash, which is subject to immediate taxation. As a result, the entire commuted value of their pension benefit entitlement may not receive tax deferral. Given that registered pension plans are tax-deferred arrangements, this forced immediate taxation on the lump sum versus deferred taxation of benefits received during retirement is punitive. The unintended unlocking of this taxable cash amount is also contrary to the general retirement policy goal of preserving the lump sum value of pension benefits exclusively for retirement income. The cash distribution of retirement savings can result in depriving Canadian plan participants of a timely or adequate retirement.

In accordance with provisions of the Act and the Regulations, all defined benefit member entitlements are subject to specific and detailed limits on the amount of annual pension benefit a member can be provided. *Regulation 8517* imposes a second limit test on a member's benefit. Under a DC arrangement, the amount of contributions permitted are subject to limits, but the lump sum values are not limited a second time at future transfers. Given that a defined benefit entitlement is already subject to limits on the amount of pension provided, there should not be an additional restriction on a member's commuted value.

In periods of very low interest rates, when an annual pension benefit commuted value is higher and more likely to be subject to the 8517 restriction, the member is exposed to low interest rates on fixed income investments. Conversely, when interest rates are very high, the commuted value is lower, potentially avoiding the 8517 restriction. Thus, the impact of *Regulation 8517* is quite sensitive to prevailing fixed-income yields at the time the commuted value is prepared. Penalizing (through 8517) a member from replicating their pension in a low fixed-income yield environment while having less impact on a member in a high fixed-income environment appears illogical.

When large portions of pension benefits are paid in cash, it is extremely unlikely that the individual will be able to replicate the benefit that would have been paid from the DB pension plan. Portability options for plan members should not be subject to rules that result in materially smaller pension benefits available during retirement.

The following table illustrates the impact on a member who chooses to transfer the commuted value of their pension upon termination to a LIRA. Unless this individual is an extremely savvy and lucky investor, it is highly unlikely they will achieve the investment returns necessary to make up for the loss of funds due to immediate taxation.

Age	**Annual Pension**	**Annuity Factor[1]**	**Commuted Value**	**8517 Factor**	**Maximum Transfer Value**	**Amount Subject to Immediate Taxation**
32	$14,000	18.5	$259,000	9.0	$126,000	$133,000
48	$58,300	22.3	$1,300,090	9.0	$524,700	$775,390

There are many valid reasons why members choose a commuted value for their defined benefit pension entitlement. Some examples include a desire for flexibility in financial planning (such as delayed retirement or part time work in retirement), actual or perceived shorter life expectancy, or a preference for investing in riskier assets with the expectation of a higher return (which could lead to higher future benefits and, ultimately, higher income taxes on those amounts when withdrawals occur). Although many defined benefit plan members choose to take a monthly pension upon retirement, there are still some for whom a commuted value makes sense based on their personal circumstances.

Not all jurisdictions require that an annuity purchase be offered to terminating members as a transfer option. As a result, DB pension plan members who want a transfer due to concerns about benefit security under the original plan (i.e., those who actively review their statements and track their plan's funded status) must choose between the risk of leaving their funds in the pension plan or accepting the cash consequences of the *Regulation 8517* limit. This means they will have no opportunity to purchase an

[1] Assumptions: Fully indexed plan (including in the deferral period), optimal age / unreduced benefits at age 60, fully subsidized 60% joint and survivor normal form, CIA July 2019 discount rate assumptions of 1.2% for 10 years, 1.3% thereafter for a fully indexed plan with mortality table CPM2014 with generational projection using scale CPM-B, 50% male unisex (spouses same age as member).

annuity from their prescribed vehicle that is anywhere near the value of their pension. Additionally, not all jurisdictions allow financial hardship unlocking directly from the pension plan. As a result, members who have terminated their employment can only access this option by first transferring to a prescribed vehicle, where they then become subject to the *Regulation 8517* rules – an outcome that disproportionately affects those who can least afford it.

We strongly urge the repeal of Section 8517 of the *ITA Regulations*. Registered pension plans (RPPs) should maintain their special status as tax-deferred arrangements for retirement years. Plan members who exercise portability rights should not be disadvantaged compared to those who leave their pension entitlements with former employers.

2. New Trust Reporting Rules and Application to RCAs: Exemption Needed for Workplace Top Up Plans

Expanded trust reporting rules, recently introduced, require trusts with taxation years ending on or after December 31, 2023, to provide information about "reportable entities," which include beneficiaries, trustees, settlors and protectors of a trust. A completed Schedule 15, *Beneficial Ownership Information of a Trust*, must be filed annually along with the T3 Trust Income Tax and Information Return under the new rules.

Under Part B of Schedule 15, the trust must specify whether the reportable entity is a natural person, corporation, trust or other entity. It must then provide the name, address, date of birth (if a natural person), jurisdiction of residence and taxpayer identification number for each reportable entity. Trustees are also required to report contingent beneficiaries, regardless of how remote their interest may be.

Under the prior rules, generally, only trusts with taxes payable for the year or those that disposed of capital property were required to file an annual trust return. However, under the expanded rules, many trusts are now required to file a T3 return, including Retirement Compensation Arrangement (RCA) trusts.

Paragraph 150(1.2) (n) of the ITA excludes certain trusts related to workplace plans (see below). It broadly covers workplace plans **except for** RCA trusts associated with supplemental retirement plans that provide benefits exceeding those of an underlying registered pension plan due to ITA benefit limits (top-up RCAs):

> (n) a trust under or governed by a
>
> (i) deferred profit-sharing plan,
>
> (ii) pooled registered pension plan,
>
> (iii) registered disability savings plan,
>
> (iv) registered education savings plan,
>
> (v) registered pension plan,
>
> (vi) registered retirement income fund,

(vii) registered retirement savings plan,

(viii) tax-free savings account,

(ix) employee profit sharing plan,

(x) registered supplementary unemployment benefit plan, or

(xi) first time home saving account;

In our view, workplace plan top-up RCAs should be added to the list of plans outlined in paragraph 150(1.2)(n) of the ITA and exempted from the new reporting requirements. Since these requirements are overly burdensome for plan administrators, we strongly urge that this change to the ITA be implemented before the next T3 reporting deadline in 2025.

3. Overpayments and Overpayment Recovery

Upon the death of a pension plan beneficiary, there is usually a delay before the plan administrator is notified and can initiate the process to stop pension payments and distribute any remaining survivor benefits. This delay often results in the overpayment of pension benefits, which the plan, as part of its fiduciary duty, will seek to recover through a repayment from the estate.

Current guidance from the Canada Revenue Agency (CRA) is found in the CRA Registered Plans Directorate Newsletter 18-1: Repayments to Registered Pension Plans (May 17, 2019). This guidance discusses the tax deduction available under ITA s. 60(n.1) for the return of pension plan benefits paid in error. In cases of overpayments made after the death of a pensioner, this deduction applies to repayments made by the member's estate.

Under this approach, the estate must return the gross overpayment amount to be made whole. However, this amount is often larger than what was received by the deceased, as a portion of the pension overpayment was remitted directly to the CRA as tax withheld at source. This creates challenges for the plan in recovering the full amount. Additionally, this approach is not viable when the overpaid amount is returned by someone other than the member's estate – such as a deceased plan member's spouse if the estate has been closed. It also does not apply to any overpayment from a supplementary plan.

The recovery of overpaid benefits is a costly and lengthy process for plan administrators. When overpayments cannot be recovered, the pension fund is negatively impacted. The process can also delay the final settlement of the estate, preventing survivors or other beneficiaries from receiving the death-related benefits to which they are entitled. In cases where the pension plan is not informed of the beneficiary's death for several years, relatives who unknowingly received pension overpayments may later be required to return them, leading to potential financial hardship.

Given these considerations, preventing improper pension payments to deceased individuals and establishing an efficient mechanism for recovering overpayments are urgent matters requiring legislative change.

The initiatives outlined below would support pension plan administrators in the overpayment recovery process by reducing repayment amounts owed by the estate and minimizing the frequency and impact of overpayments.

i. Permit pension plan administrators to recover tax withheld at source through a credit from CRA to accommodate repayment by the estate of the net overpayment amount

This measure aims to reduce the repayment amount owed by the estate by ensuring it is not required to return more than was originally received by the plan beneficiary. This could be achieved by amending the withholding rules in ITA s. 153 to allow repayment of only the net overpayment amount to the pension plan while permitting the plan to recover the excess withholding tax through a credit on its CRA account.

The ITA was amended in 2019 with the addition of s. 153(3.1) to streamline how employers recover overpayments of remuneration to employees. This provision allows employees to repay only the net portion of an overpayment while enabling the employer to receive a payroll credit for the excess tax remitted to the CRA. This amendment was introduced as part of the federal government's response to errors associated with the Phoenix payroll system for federal employees and is now available to all employers. The process is described on the CRA Payroll page: Correcting Reporting Errors and Salary Overpayments.

However, it appears that this provision does not apply to the repayment of pension benefits, as "remuneration" in this context does not seem to include pension amounts. Additionally, s. 153(3.1) refers specifically to overpayments resulting from a "clerical, administrative, or system error." Amending the ITA to extend this approach to pension, superannuation, and supplemental plans (e.g., retirement compensation arrangements) would better support pension overpayment recovery and simplify administrative processes.

Ideally, this provision should also be extended to allow the pension plan to receive a credit for the excess withholding tax when the net repayment amount is made by another taxpayer on behalf of the deceased pensioner (e.g., the member's surviving spouse), particularly if the estate has been closed.

Upon the return of the net overpayment amount, the pension plan would issue a T4A (or T4A-RCA, as applicable) reflecting the corrected amount if repayment occurs in the year of death. If repayment is made in a later year, the plan would issue amended tax slips for the relevant years. The estate would be made whole upon the CRA's reassessment of the affected years.

ii. Provide confirmation of a plan beneficiary's death to pension plan administrators

This second measure would aid in the recovery of overpayments by reducing both their occurrence and duration. We request that the CRA establish a service enabling plan administrators to verify whether a plan beneficiary has passed away. Currently, the available options for obtaining such confirmation—such as professional locator services—are costly and often ineffective. Additionally, plan administrators face practical limitations when relying solely on internal records management and audit programs.

By contrast, the CRA is typically one of the first entities to receive formal notice of a taxpayer's death. Therefore, our proposal has the potential to significantly reduce pension overpayments to deceased individuals.

We acknowledge that Section 241 of the ITA restricts the CRA's ability to share taxpayer information with plan administrators. However, we believe our proposal aligns with paragraph 241(4)(b) of the Act, which permits the disclosure of taxpayer information when it is reasonably necessary for determining any tax that is or may become payable, or any other relevant amount. Under our proposal, plan administrators would be able to confirm whether a pension amount remains payable to the taxpayer, which is directly relevant to income tax calculations.

Moreover, as noted above, preventing pension payments to deceased individuals would also assist the CRA by ensuring the correct amount of tax is remitted.

If implemented, these measures—particularly in combination—would provide valuable support to pension plan administrators by helping them fulfill their obligations to plan beneficiaries and mitigate the risks associated with continued payments after death. Additionally, these changes would support the timely settlement of estates, reduce the burden on surviving relatives, and improve the accuracy of tax reporting to the CRA.

4. Measures to Address Increasing Life Expectancy

i. Tax Reforms to Address Longevity: Raise Mandatory Retirement Income Commencement from Age 71 to 75

A study published in *The Lancet* in February 2017 forecasts that a girl born in Canada in 2030 will have a life expectancy of 87 years, while a boy will live to nearly 84 years. For comparison, the life expectancy for females born in 2010 is approximately 84 years, and just over 79 years for males.

Longer lifespans will inevitably reshape how we live, save, and plan for retirement. However, under the ITA, Canadians are required to begin withdrawing from registered retirement vehicles no later than the end of the calendar year in which they turn 71.

Given current longevity projections, the age 71 restriction for tax deferrals should be gradually increased to age 75 over time. This adjustment would provide greater flexibility for Canadians as they plan and save for retirement.

ii. Review Minimum Withdrawals from Registered Retirement Income Funds (RRIFs)

The current rules requiring minimum annual withdrawals from RRIFs contribute to income insecurity among Canadian retirees. Under existing regulations, Canadians with retirement savings in RRSPs must convert their savings into RRIFs and begin making withdrawals. These RRIF withdrawal rules deplete assets by age 95 and often force retirees to withdraw funds earlier than they need or want to, increasing the risk that they will outlive their retirement savings.

The RRIF withdrawal rules have not kept pace with rising longevity rates, longer retirement periods, and declining access to workplace retirement plans. When these rules were first introduced in 1978 and later revised in 1992, life expectancy and time spent in retirement were significantly shorter than they are today. In contrast, Canadians now spend considerably more time in retirement than they did in 1978 and 1992, making them far more likely to exhaust their savings in later years.

We encourage the CRA to proactively review and update the minimum withdrawal rates to reflect current and future longevity trends.

5. Eliminate or Increase Surplus Threshold

The surplus threshold outlined in paragraph 147.2(2)(d) of the ITA limits the funding of defined benefit (DB) plans to 125% on a going concern basis. We recommend eliminating or significantly increasing this threshold for multi-employer plans. Such a change would enhance the long-term sustainability of these plans by strengthening their ability to withstand economic downturns and supporting their capacity to provide valuable benefits, such as cost-of-living increases.

Similarly, we recommend removing the contribution limits under ITR 8503(4) or, at a minimum, updating the Factor 9 to reflect current economic realities and the increased use of provisions for adverse deviations as an appropriate risk management tool for funding sustainability.

Currently, these limits can be waived through ministerial approval under ITR 8503(5). Eliminating these limits—or at least updating the Factor 9—would reduce the administrative burden associated with requesting ministerial waivers.

6. Add Administrative Fees to Permissible Plan Contributions

Several jurisdictions with minimum standards allow pension plan administrators to charge members and/or their former spouses a fee for services related to pension division in the event of a relationship breakdown.

Adding a new category of administrative fees to the list of permissible contributions under Section 8502(b) of the Regulations would enable pension plans to adopt these provisions and offset some of the costs associated with providing these services.

7. Requested Regulatory Policy Change: Authorize Pension Plan Administrators to Mask SINs

The CRA has taken the position that pension plan administrators may not fully or partially mask members' Social Insurance Numbers (SINs) on required communications, such as T4As.

However, masking SINs is a simple and effective measure to help protect individuals from identity theft and fraud. The CRA's stance is difficult to justify, especially considering that the CRA itself masks SINs on its own communications.

We request that pension plan administrators be granted clear authority to mask members' SINs on all member communications.

8. Conclusion

The Canadian retirement system has undergone significant changes and transitions over the past three decades, following the major overhaul of the registered plan taxation system in the early 1990s.

To remain effective, the ITA rules governing registered plans must continue to be modernized and updated to keep pace with today's socioeconomic environment, increasing life expectancy, and innovations in retirement plan design.

The implementation of the reforms identified by ACPM would help achieve these critical objectives.